

BEFORE THE
POSTAL RATE COMMISSION
WASHINGTON, D.C. 20268-0001

RATE AND SERVICE CHANGES TO) Docket No. MC2004-4
IMPLEMENT FUNCTIONALLY EQUIVALENT)
NEGOTIATED SERVICE AGREEMENT WITH)
DISCOVER FINANCIAL SERVICES, INC.)

VALPAK DIRECT MARKETING SYSTEMS, INC. AND
VALPAK DEALERS' ASSOCIATION, INC.
FIRST INTERROGATORIES AND REQUESTS FOR PRODUCTION OF
DOCUMENTS TO UNITED STATES POSTAL SERVICE
WITNESS ALI AYUB (VP/USPS-T1-1-11)
(July 21, 2004)

Pursuant to sections 25 through 27 of the Rules of Practice of the Postal Rate
Commission, Valpak Direct Marketing Systems, Inc. and Valpak Dealers' Association, Inc.
hereby submit the following interrogatories and requests for production of documents.

Respectfully submitted,

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Valpak Dealers' Association, Inc.

VP/USPS-T1-1.

- a. Please refer to your Appendix A, page 2, and confirm that the incremental volume of the First-Class Marketing mail of Discover Financial Services, Inc. (“DFS”) is projected to be as follows for Years 1, 2 and 3:

Year 1: 13 million pieces

Year 2: 18 million pieces

Year 3: 18 million pieces

If you do not confirm, please provide what you believe to be the correct volumes.

- b. Please refer to your Appendix A, page 1, row 2, and confirm that the projected return rate forecast for DFS’s Marketing mail in Years 1, 2 and 3 is 9.3 percent.
- c. Please confirm that, at the assumed return rate for Marketing mail of 9.3 percent, the incremental volume of Marketing mail discussed in preceding part a will result in the following incremental volume of returns:

Year 1: 1.209 million pieces

Year 2: 1.674 million pieces

Year 3: 1.674 million pieces

If you do not confirm, please provide what you believe to be the correct volumes.

- d. Please confirm that, with the assumptions used to compute the costs shown in your Appendix A, page 7, line 11, the Postal Service’s total cost to handle the incremental volume of DFS’s returns discussed in preceding part c will be as shown here. If you do not confirm, please provide what you believe to be the correct cost for the Postal Service to handle the incremental volume of DFS’s After-NSA returns.

Year 1: \$452,650

Year 2: \$651,815

Year 3: \$677,888

- e. Please confirm that the incremental return cost per piece of incremental volume shown in preceding part a will be as follows:

Year 1: \$0.0348

Year 2: \$0.0362

Year 3: \$0.0377

If you do not confirm, please provide what you believe to be the correct unit cost for the Postal Service to handle the incremental volume of DFS's After-NSA returns shown in part a above.

VP/USPS-T1-2.

- a. Your Appendix A, page 10, line 6, indicates that (i) the First-Class Marketing letter cost per piece before rates in Year 3 will be \$0.164, and (ii) on line 8 the First-Class Marketing letter contribution per piece before rates will be \$0.129. Your testimony at page 6, line 18, indicates that when DFS's annual volume exceeds 515,000,000, the applicable discount will be at the maximum level, \$0.045 per piece. Please refer to VP/USPS-T1-1, part e, and confirm that, at volumes above 515,000,000, the **marginal** contribution derived from each piece of Marketing mail in Year 3 will be as follows:

First-Class Marketing Letter Contribution Before Rates	\$0.1290
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Less: Incremental return cost per piece	<u>\$0.0377</u>
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Marginal contribution per piece After Rates

\$0.0913

If you do not confirm, please explain what you believe will be the marginal contribution per piece of Marketing mail in Year 3, after taking into account the incremental return cost and assuming the maximum discount is applicable.

- b. Please confirm that the **marginal** contribution per piece of First-Class Marketing mail After Rates in Year 3 is somewhat less than the **average** First-Class Marketing Letter Contribution Before Rates of \$0.129 shown on line 8 of Appendix A, page 10. If you do not confirm, please explain fully.
- c. Please confirm that the **marginal** contribution per piece of First-Class Marketing mail After Rates, as computed in preceding part b above, slightly exceeds, by \$0.0073, the Standard Letter Contribution per piece of \$0.0840 shown on line 12 of Appendix A, page 10. If you do not confirm, please explain fully.

VP/USPS-T1-3.

- a. Please confirm that the Postal Service's systemwide average Undeliverable as Addressed ("UAA") return rate for First-Class Mail is 1.23 percent. If you do not confirm, please provide what you believe to be the correct rate, indicate the year or years to which that return rate applies, and the source of any datum you provide.
- b. Please confirm that the Postal Service's systemwide average rate for forwarding UAA mail that is forwardable is 1.96 percent. If you do not confirm, please provide what you believe to be the correct forwarding rate, indicate the year or years to which that rate applies, and the source of any datum you provide.

- c. Please confirm that if the systemwide forwarding rate for First-Class Mail is 1.96 percent, and the systemwide return rate First-Class Mail is 1.23 percent, then the ratio of pieces forwarded to pieces returned is 1.5935; *i.e.*, for every 10,000 pieces returned, 15,935 pieces need to be forwarded. If you do not confirm, please provide what you believe to be the correct systemwide ratio for First-Class Mail, and indicate the source and derivation of any different ratio(s) you provide, and the year or years on which the underlying data are based.
- d. Please confirm that for Standard Mail the ratio of pieces forwarded to pieces returned is 2.472 (*see* Domestic Mail Classification Schedule (“DMCS”), Sec. 353 and Domestic Mail Manual (“DMM”) F010.5.3; *see also* Docket No. MC2002-2, response of Postal Service witness Charles L. Crum to OCA/USPS-T3-25, Tr. 2/337); *i.e.*, for each 10,000 pieces of Standard Mail that is returned, 24,720 pieces need to be forwarded. If you do not confirm, please provide what you believe to be the correct ratio for Standard Mail, and indicate the source and derivation of any different ratio(s) you provide, the year or years on which the underlying data are based, and their source.

VP/USPS-T1-4.

- a. Please confirm that if the Postal Service has to forward 15,935 pieces of mail for each 10,000 pieces that are returned, then the incremental volume of DFS Marketing mail and the incremental volume of returns that such mail will generate, as shown in preceding interrogatory VP/USPS-T1-1, will result in the Postal Service having to forward the following additional volumes of mail:

Year 1: 1.927 million pieces

Year 2: 2.668 million pieces

Year 3: 2.668 million pieces

If you do not confirm, please provide what you believe to be the correct volumes of forwarded mail that will be result from DFS's incremental Marketing mail generated by the proposed Negotiated Service Agreement ("NSA"), based on the systemwide averages and ratio for First-Class Mail, and explain the derivation.

- b. To your knowledge, do the Postal Service or DFS have any data on the number of pieces of DFS's First-Class Marketing mail that were forwarded in 2003 (or any prior period)?

VP/USPS-T1-5.

Please confirm that if the Postal Service has to forward 24,720 pieces of mail for each 10,000 pieces that are returned, then the incremental volume of DFS Marketing mail and the incremental volume of returns that such mail will generate, as shown in VP/USPS-T1-1, will result in the Postal Service having to forward the following additional volumes of mail:

Year 1: 2.989 million pieces

Year 2: 4.138 million pieces

Year 3: 4.138 million pieces

If you do not confirm, please provide what you believe to be the correct volumes of forwarded mail that will be result from DFS's incremental Marketing mail generated by the proposed NSA, based on the best data available for the Standard Mail ratio, and explain how you derive

your results, give the source of whatever ratio you use, and explain fully why it is more appropriate than 2.472.

VP/USPS-T1-6.

- a. Please confirm that the Postal Service's cost to forward a piece of First-Class Mail in FY 2000 was 30.7 cents. If you do not confirm, please provide what you believe to be the correct cost.
- b. Please confirm that with a 4.0 percent inflation rate since FY 2000, the cost of forwarding a piece of First-Class Mail in FY 2004 would be approximately 35.9 cents.
- c. Please provide the best and most recent estimate of the unit cost for the Postal Service to forward a First-Class letter, indicate the year to which the datum is applicable and the source.

VP/USPS-T1-7.

- a. Please confirm that at a unit cost of 30.7 cents per piece to forward a piece of First-Class Mail, the total incremental cost to forward the additional volume of DFS First-Class Marketing mail shown in preceding VP/USPS-T1-4 would be as follows:

Year 1:	\$591,448
Year 2:	\$818,928
Year 3:	\$818,928

If you do not confirm, please provide what you believe to be the correct incremental costs of forwarding, using FY 2000 data, and explain the derivation.

- b. Please confirm that at unit cost of 35.9 cents per piece to forward a piece of First-Class Mail (which reflects a 4 percent annual inflation since FY 2000), the total cost to forward the additional volume of DFS First-Class Marketing mail shown in preceding VP/USPS-T1-4, would be as follows:

Year 1:	\$691,911
Year 2:	\$958,030
Year 3:	\$958,030

If you do not confirm, please provide what you believe to be the correct incremental costs of forwarding, using FY 2004 data, and explain the derivation.

- c. Please confirm that the incremental costs of forwarding, shown in preceding parts a and b, when divided by the total incremental volume of DFS Marketing mail shown in VP/USPS-T1-1, part a, results in the following incremental costs per piece:

	<u>@30.7</u> <u>Cents</u>	<u>@35.9</u> <u>Cents</u>
Year 1:	\$0.0455	\$0.0532
Year 2:	\$0.0455	\$0.0532
Year 3:	\$0.0455	\$0.0532

If you do not confirm, please provide what you believe to be the correct incremental unit cost of forwarding the above-referenced volume of mail, and explain the derivation.

VP/USPS-T1-8.

- a. Please confirm that at a unit cost of 30.7 cents per piece to forward a piece of First-Class Mail, the total incremental cost to forward the additional volume of DFS First-Class Marketing mail shown in preceding VP/USPS-T1-5 would be as follows:

Year 1: \$ 917,515

Year 2: \$1,270,405

Year 3: \$1,270,405

If you do not confirm, please provide what you believe to be the correct incremental costs of forwarding, using FY 2000 data, and explain the derivation.

- b. Please confirm that at a unit cost of 35.9 cents per piece to forward a piece of First-Class Mail (which reflects a 4 percent annual inflation since FY 2000), the total cost to forward the additional volume of DFS First-Class Marketing mail shown in preceding VP/USPS-T1-5, would be as follows:

Year 1: \$1,073,363

Year 2: \$1,486,195

Year 3: \$1,486,195

If you do not confirm, please provide what you believe to be the correct incremental costs of forwarding, using FY 2004 data, and explain the derivation.

- c. Please confirm that the incremental costs of forwarding, shown in preceding parts a and b, when divided by the total incremental volume of DFS Marketing mail shown in VP/USPS-T1-1, part a, results in the following incremental costs per piece:

	<u>@30.7</u> <u>Cents</u>	<u>@35.9</u> <u>Cents</u>
Year 1:	\$0.0706	\$0.0826
Year 2:	\$0.0706	\$0.0826
Year 3:	\$0.0706	\$0.0826

If you do not confirm, please provide what you believe to be the correct incremental unit cost of forwarding the above-referenced volume of mail, and explain the derivation.

VP/USPS-T1-9.

- a. Please confirm that the projected source of DFS's incremental Marketing mail volume shown in response to VP/USPS-T1-1, part a, will be from the lists that would have been entered as Standard Mail, but instead will be converted to First-Class Mail as a result of the inducements contained in the proposed NSA. If you do not confirm, please explain your understanding of the source of DFS's incremental First-Class Marketing mail volumes.
- b. VP/USPS-T1-3, parts c and d, discussed two different ratios for the number of UAA pieces forwarded per piece of UAA mail returned — one based on systemwide averages for First-Class Mail, and the other based on data for Standard Mail. In your opinion, as between these two averages, which would be the more appropriate one to use with respect to the volume of forwarded pieces likely to arise from DFS's incremental volume of Marketing mail? Please explain fully.

VP/USPS-T1-10.

- a. Please confirm that at the present time, whenever the Postal Service forwards a piece of DFS's First-Class Marketing mail that is UAA but forwardable, DFS does not receive any kind of notice or other information that the piece has been forwarded. If you do not confirm, please explain fully all information and feedback that the Postal Service currently supplies to DFS when its First-Class Marketing mail is forwarded.
- b. Please confirm that under the proposed NSA the Postal Service will provide DFS with electronic address corrections for (i) all of its UAA Marketing mail that is forwarded, as well as for (ii) all Marketing mail that is UAA and non-forwardable and entitled to free physical return; *i.e.*, the volume of electronic returns to be provided under the proposed NSA will exceed (by some unstated number) the volume of non-forwardable UAA mail. If you do not confirm, please explain fully what DFS can expect to receive from the Postal Service regarding its First-Class UAA mail.
- c. Please refer to your Appendix A, page 7, and confirm that the Return Forecast for the volume of Marketing mail shown on line 6 (i) reflects only the Before Rates volumes shown on line 4 multiplied by the 9.3 percent Return Rate on line 2, and excludes the incremental volume of returns that will arise by virtue of the incremental volume of Marketing mail; and (ii) does not include any returns for DFS's UAA Marketing mail that is being or will be forwarded and for which the Postal Service also will generate an electronic address correction under the proposed NSA. If you do not confirm, please explain fully what the data on line 6 include, and what they exclude.

- d. Please confirm that the After Rates Return Costs for Marketing mail, shown on line 11, is only for the return volumes shown on line 6, and does not reflect the total cost of returns that the Postal Service will be required to provide under the proposed NSA. If you do not confirm, please explain.

VP/USPS-T1-11.

- a. Please confirm that the cost and revenue model in USPS-T-1, Appendix A, does **not** include (i) any cost for forwarding of DFS First-Class Marketing mail, or (ii) any cost for providing DFS with electronic address corrections for DFS First-Class Marketing mail that will be forwarded after the proposed NSA becomes effective. If you did include costs for either or both of the preceding two items, please indicate where in your Appendix A such figures appear.
- b. Please refer to preceding interrogatory VP/USPS-T1-2, which computed the marginal contribution to the Postal Service's overhead After Rates in Year 3 as \$0.0913, and preceding interrogatory VP/USPS-T1-7(c), which computed incremental forwarding costs in Year 3 of \$0.0455 with no inflation, and \$0.0532 with a 4 percent inflation. Since these incremental forwarding costs are a direct result of implementing the proposed NSA, would you agree that it would be appropriate to deduct such costs when estimating the net marginal contribution? Please explain fully any disagreement.
- c. Assuming that you consider it appropriate for the final analysis to include Postal Service costs that predictably and directly arise from the proposed NSA, would you

agree that the following reflects a reasonable estimate for Year 3 of the marginal contribution to overhead for pieces that exceed the 515,000,000 volume threshold?

Marginal contribution per piece After Rates	\$0.0913
Incremental cost of forwarding	<u>\$0.0532</u>
Net marginal contribution per piece	\$0.0381

If you do not agree, please provide what you consider to be the most appropriate marginal contribution, and explain fully why it is more appropriate than \$0.0378.

- d. Would you agree that if your cost-revenue model in Appendix A were to include any adjustment in excess of \$0.0075 for the incremental cost of forwarding arising from the proposed NSA, then the marginal contribution in Year 3 at volumes in excess of 515,000,000 will be less than the contribution from Standard Mail (\$0.0840) as shown in your Appendix A, page 10, line 12? If you do not agree, please provide the maximum adjustment that you could make for the cost of forwarding without falling below the \$0.0840 threshold, and explain how you arrive at your answer.